No. 10249.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

ELSA METZ MASON,

Appellant,

vs.

THOMAS MITCHELL,

Appellee.

APPELLANT'S OPENING BRIEF.

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Facts and Authorities Regarding Jurisdiction.

Appellant, Elsa Metz Mason, for and on behalf of herself and Thomas Mitchell, as co-partners, filed a partnership petition in bankruptcy [R. 2-4] on October 21, 1941, in the District Court of the United States for the Southern District of California, Central Division. The said Court had jurisdiction of said proceedings by virtue of the provisions of subdivision (1) of section 2a, and subdivisions (a), (b) and (d) of section 5 of the Bankruptcy Act.

A final order affirming an order of the Referee in Bankruptcy which dismissed said partnership petition was entered for respondent on June 29, 1942 [R. 32-33]. Notice of appeal was filed by appellant on August 5, 1942, and a copy thereof was served on the attorneys for respondent on August 5, 1942 [R. 34]. Appellant then

served and filed his statement of points on which he intends to rely and designation of parts of the record for consideration on appeal on August 8, 1942 [R. 35-36]. The record was certified on September 11, 1942, and filed in this Circuit Court on September 12, 1942 [R. 38-39].

Appellant relies upon the provisions of subdivisions (a) and (b) of section 24 and section 25a of the Bankruptcy Act to sustain the jurisdiction of this Circuit Court to review said order on appeal. The provisions of section 25a of the Bankruptcy Act sustain the jurisdiction of this Circuit Court in so far as the time within which to appeal from said judgment is concerned. The proceedings mentioned in the preceding paragraph were completed pursuant to Federal Rules of Civil Procedure, Rule 73 (a), (b), (c) and (g), and Rule 75.

Statement of the Case and Question Involved.

As hereinbefore indicated, the partnership petition in bankruptcy filed by appellant, Elsa Metz Mason, alleged only the insolvency of the partnership, but was silent on the subject of the solvency or insolvency of the individual partners [R. 2-4]. Respondent, Thomas Mitchell, filed an answer [R. 4-9] to the partnership petition in which he denied his membership in the partnership, alleged that his assets were in excess of the total combined debts of the alleged partnership, of appellant individually and of himself, and further denied that the partnership was insolvent. Respondent prayed that the petition be dismissed as to him.

At the trial of the cause it was stipulated that when said petition was filed, and at all times mentioned therein, respondent had sufficient assets other than those exempt from execution, to pay all of his personal debts, all of

the debts of appellant and all of the debts of said alleged partnership. This stipulation, without the further introduction of evidence, was the ground upon which the Referee made his order dismissing the petition of appellant. As stated in the order of the Referee [R. 11-12]:

> "The issue was, therefore, directly presented as to the legal requirement of pleading and proof with respect to the Insolvency of the partnership, and, although the respective parties indicated that a trial of the issues presented by the said pleadings would take at least four days' Court time, the real issue which may be determinative of the entire case was then framed upon and about the simple proposition, 'when is a partnership (under Section 5 of the Bankruptcy Act) insolvent?'
>
> Upon this sole point the matter was presented to the Referee for determination."

A more factual statement of the issue may be set forth as follows: In a proceeding to adjudicate a partnership bankrupt is it necessary to allege or prove any facts concerning the assets of the individual partners? Or, in other words, is it material to determine, in the adjudication of the bankruptcy of a partnership, whether the partners, or any of them, have sufficient assets apart from their interest in the partnership to satisfy the obligations of such partnership?

It is the position of the appellant that a partnership is an entity distinct and separate from its member partners in so far as its adjudication in bankruptcy under section 5a of the Bankruptcy Act is concerned, and that the amount of assets of any individual partner, apart from his interest in the partnership, is entirely immaterial in the determination of the bankruptcy of such partnership.

ARGUMENT.

I.

A Partnership Petition in Bankruptcy, Otherwise Adequate, Is Sufficient to Entitle the Petitioner to an Adjudication Even Though It Contains No Allegation Concerning the Financial Condition of the Individual Partners, and Even Though the Proof Shows That One of the Partners Has Sufficient Funds to Pay All of His Personal Debts Plus Those of the Partnership.

Subdivisions (a) and (b) of section 5 of the Bankruptcy Act are as follows:

> "(a) A partnership, including a limited partnership containing one or more general partners, during the continuation of the partnership business or after its dissolution and before the final settlement thereof, may be adjudged a bankrupt either separately or jointly with one or more or all of its general partners.
>
> (b) A petition may be filed by one or more or all of the general partners in the separate behalf of a partnership or jointly in behalf of a partnership and of the general partner or partners filing the same: *Provided, however,* That where a petition is filed in behalf of a partnership by less than all of the general partners, the petition shall allege that the partnership is insolvent. A petition may be filed separately against a partnership or jointly against a partnership and one or more or all of its general partners."

These subdivisions should ordinarily present no difficulties of construction. When Congress provided that ". . . The petition shall allege that the partnership is insolvent," it clearly intended that such allegation should be sufficient

to support the petition from which it likewise follows that proof thereof should entitle a petitioner to adjudication. The Referee and the District Judge fell into error by following decisions under the Bankruptcy Act prior to its amendment by the Chandler Act in 1938.

Section 5 (a) prior to the adoption of the Chandler Act in 1938, read as follows:

> "A partnership during the continuation of the partnership business or after its dissolution and before the final settlement thereof, may be adjudged bankrupt."

The Chandler Act added "either separately or jointly with one or more or all of its general partners." This language is the first indication that it was the intent of Congress that the partnership should be considered as a separate entity. If the net assets of the individual partners must be considered as assets of the partnership, then the partnership is not being adjudicated separately.

The Chandler Act then next added subdivision (b) and provided that one or more of the general partners might file a petition upon its behalf and when so filed by less than all of such partners "the petition shall allege that the partnership is insolvent."

Observe the absence of any language referring to the insolvency of anyone other than the partnership. Had Congress included the words "the partnership and all the members thereof" or applied the definition used in Section 67 a (5) a (1), the Referee's construction would be amply supported, but the present construction is judicial legislation.

Elsewhere in the Chandler Act the intent to treat the partnership as a separate entity is apparent. For in-

stance, Subdivision 19 of Section I provides that a person shall be deemed insolvent "whenever the aggregate of his property" shall not be sufficient to pay his debts. Under Subdivisions 23, 33, 34 and 35 of Section I, Subdivision 19 of Section I, as applied to this situation should be read, "A partnership shall be deemed insolvent . . . whenever the aggregate of its property," etc.

Under the Bankruptcy Act before its amendment by the Chandler Act in 1938, courts had no legislative guide as a basis for determining whether or not the net assets of individual partners should be included with the assets of the partnership and some courts (there being considerable conflict in the decisions as will be hereafter discussed), held that in view of the fact that under the Bankruptcy Act the Bankruptcy Court in marshalling assets was given jurisdiction to require that if the partnerships' assets were not sufficient to pay its liabilities, the net assets of the individual partners could be administered by the Trustee and applied to the payment of the partnerships' debts, and also because under the state law each partner is liable for all of the debts of the partnership, no involuntary bankruptcy proceeding would lie if the net assets of the individual partners were sufficient to pay the partnership liabilities.

Now, however, we have further light on the intent of Congress in Section 67 which contains the very provision that appellee contends should be in Section 5, or stated differently, reads as appellee would have Section 5 read. Section 67 a (5) d (1) reads: "For the purposes of, and exclusively applicable to, this subdivision d: . . ."

> "(d) A person is 'insolvent' when the present fair salable value of his property is less than the amount required to pay his debts; and to determine whether

> a partnership is insolvent, there shall be added to the partnership property the present fair salable value of the separate property of each general partner in excess of the amount required to pay his separate debts and also the amount realizable on any unpaid subscription to the partnership of each limited partner;"

Here is the exact phraseology which appellee desires and, in fact, requires to sustain his position, but Congress limited its application exclusively to that particular subdivision, which concerns fraudulent and voidable transfers.

Could legislative intent be more clearly indicated? Congress said, in so many words,

> "Only when considering fraudulent and voidable transfers under Section 67, the net assets of general partners shall be considered in determining solvency. When proceeding under Section 5, the partnership shall be treated as a separate entity."

As previously stated, the point is entirely new and decisions under the Bankruptcy Act prior to the amendment furnished no precedent in construing this new section. While under the former act, some courts held that the net assets of the individual partners must be considered in determining the insolvency, the decisions were by no means uniform. *Liberty National Bank v. Bear*, 276 U. S. 213, 11 Am. B. R. (N. S.) 243, which we believe throws some indirect light on the question, states in the footnote:

> "Neither of the two incidental questions upon which the lower Federal Court have differed in opinion—whether a partnership can be deemed insolvent as an entity when the individual partners are solvent, and whether a bankruptcy Court which has adjudged

> a partnership a bankrupt may take possession of the individual property of a partner who has not been adjudged a bankrupt so far as is necessary to pay the partnership debts—is here involved."

Apparently, the Referee relied upon text books, the authors of which relied upon decisions rendered before the amendment to the Bankruptcy Act in 1938.

The opinions of these textbook writers are only conclusions drawn from decisions, and are hastily drawn and entitled to little weight. Not one of these authors studied the Act or gave any consideration to its various provisions or even considered the effect of the amendment. To illustrate, permit us to direct the Court's attention to a statement contained in Collier on Bankruptcy, one of the latest, and in many instances the most dependable, work which states, in its 14th Edition, Volume One, page 698, as follows:

> "It seems logical, therefore, in determining the insolvency of a partnership, that not only must the firm assets be insufficient to pay its debts, but also that the assets of the individual members after the payment of their individual debts, be insufficient to make up the deficiency on the firm debts."

Yet the author later in the same paragraph says:

> "The Supreme Court by *dictum* approved this view, (1) although it has never passed upon the point expressly. (2) It represents the weight of authority (3), even though some courts have rejected it as being at variance with the entity doctrine (4)."

Under (1) *Francis v. McNeal,* 228 U. S. 695, 30 A. B. R. 244, is cited, and under (2) this statement made:

> "The holding in Francis v. McNeal, n. 1, *supra,* was that the trustee of the firm could administer the estate of an unadjudicated partner."

All the cases cited under (3) were decided prior to the Supreme Court's decision in *Liberty Nat. Bank of Roanoke, Va., v. Bear,* 276 U. S. 313, 11 A. B. R. (N. S.) 343, which ignores the author of Collier's idea of the weight of authority and approves the decisions cited under (4). A mere glance at *Francis v. McNeal* and *Liberty Nat. Bank v. Bear* is sufficient to indicate which is applicable and controlling.

While it is our contention that there are no decisions construing the Bankruptcy Act as amended in 1938 on the question here involved, yet the United States Supreme Court in *Liberty National Bank v. Bear,* which was decided later than all of the other decisions referred to in the opinion of the Referee, approved the separate entity doctrine of partnerships in bankruptcy. If a partnership under the Bankruptcy Act prior to its amendment in 1939 was a separate entity, it is still or more so under the present Act, and if it is a separate entity, then in determining its insolvency, it must be considered as a separate entity and its assets and only its assets can be considered determining insolvency. In *Liberty National Bank v. Bear* the Court said:

> "The question arose whether an adjudication of the partnership as a bankrupt was possible or proper

without a similar adjudication of the individual partners. The Court answered the contention that the adjudication of the partnership as a bankrupt necessarily involved the adjudication of the individual partners as bankrupts, as follows:

'This contention disregards entirely the principle established by the Bankruptcy Act that a partnership may be adjudged a bankrupt as a separate entity without reference to the bankruptcy of the partners as individuals.' "

In stating the prevailing rule, the Court, at pages 222 and 223, said:

"It has long been the established rule in the Circuit Courts of Appeals and District Courts that under section 5a of the act a partnership may be adjudged a bankrupt as a separate entity under a voluntary or involuntary petition, irrespective of an adjudication of bankruptcy against the individual partners. *In re* Meyer (C. C. A., 2d Cir.), 3 Am. B. R. 559, 98 F. 976, affirming Chemical National Bank v. Meyer (D. C., N. Y.), 1 Am. B. R. 565, 92 F. 896; *In re* Mercur (C. C. A., 3d Cir.), 10 Am. B. R. 505, 122 F. 384, affirming *In re* Mercur (D. C., Pa.), 8 Am. B. R. 275, 116 F. 655; *In re* Stein & Co. (C. C. A., 7th Cir.), 11 Am. B. R. 536, 127 F. 547; Dickas v. Barnes (C. C. A., 6th Cir.), 15 Am. B. R. 566, 140 F. 849; *In re* Bertenshaw (C. C. A., 8th Cir.), 19 Am. B. R. 577, 157 F. 363; Mills v. Fisher & Co. (C. C. A., 6th Cir.), 20 Am. B. R. 237, 159 F. 897; Francis v. McNeal (C. C. A., 3rd Cir.), 26 Am. B. R. 555, 186 F. 481; *In re* Samuels & Lesser (C. C. A., 2d Cir.), 32 Am. B. R. 436, 215 F. 845; Armstrong v. Fisher (C. C. A., 8th Cir.), 34 Am. B. R. 701, 224 F. 97; Carter v. Whisler (C. C. A., 8th Cir.),

2 Am. B. R. (N. S.) 128, 275 F. 743; *In re* Dunnigan Bros. (D. C., Mass.), 2 Am. B. R. 628, 95 F. 428; *In re* Duguid (D. C., N. C.), 3 Am. B. R. 794, 100 F. 274; *In re* Garden (D. C., N. C.), 4 Am. B. R. 31, 101 F. 553; Strause v. Hooper (C. C., N. C.), 5 Am. B. R. 225, 105 F. 590; *In re* Stokes (D. C., Pa.), 6 Am. B. R. 262, 106 F. 312; *In re* Hale (D. C., N. C.), 6 Am. B. R. 35, 107 F. 432; *In re* Farley & Co. (D. C., Va.), 8 Am. B. R. 266, 115 F. 359; *In re* Pincus (D. C., N. Y.), 17 Am. B. R. 331, 147 F. 621; *In re* Solomon & Carvel (D. C., N. Y.), 20 Am. B. R. 488, 163 F. 140; *In re* Everybody's G. & M. Market (D. C., Okla.), 21 Am. B. R. 925, 173 F. 492; *In re* Latimer (D. C., Pa.), 23 Am. B. R. 388, 174 F. 824; *In re* Perlhefter & Shatz (D. C., N. Y.), 25 Am. B. R. 576, 177 F. 299; *In re* Lenoir-Gross & Co. (D. C., Tenn.), 35 Am. B. R. 774, 226 F. 227."

Among the above cases cited with approval by the Supreme Court, and entirely ignored by the Referee and the Judge in this matter, is *In re Solomon & Carvel,* 163 Fed. 140, 20 Am. B. R. 488 (D. C., N. Y.), wherein it is clearly stated that a partnership may be adjudicated a bankrupt although one of the partners is solvent. The Court, at page 140, said:

> "The present bankruptcy statute recognizes a co-partnership as an entity, to the extent that petition in bankruptcy can be filed against the partnership, and the partnership or any of its members may be adjudicated bankrupts, while one or more of the partners individually may be entirely solvent."

Another of the cases cited by the Supreme Court is *In re Everybody's Grocery & Meat Market,* 173 Fed. 492,

21 Am. B. R. 577 (D. C., Okla.). Two questions were raised in this proceeding: Firstly, whether it was necessary to allege the insolvency of the individual partners, and secondly, whether it was necessary to have the consent of the solvent partners before an adjudication of the partnership as a bankrupt could be had. Both questions were answered in the negative as follows:

> "It was not . . . necessary for the petitioning creditors in this case to allege the insolvency of the individual partners. . . . In this case it is sought only to adjudge the partnership a bankrupt, and no proceedings are instituted against any of the individual members of the partnership. It is held that it is not necessary that the consent of the solvent members of the partnership, if any, in this case should be alleged in the petition as a prerequisite to adjudication."

Also the *Liberty National Bank* case is cited with approval in the recent decision of *Schram v. Wrubel* (D. C. E. D. of Mich., 1940), 38 F. Supp. 357. Here the partnership secured a discharge in bankruptcy, but the individual partners did not. The Court held that the individual partners could be personally sued on a note of the partnership. That is, it was recognized that the partnership might be insolvent although the partners were not. Much weight was placed on section 15(b) of the Uniform Partnership Act which is exactly the same as section 2409(b) of the Civil Code of the State of California. This section provides as follows:

> "All partners are liable . . . jointly for all other debts and obligations of the partnership; but any partner may enter into a separate obligation to perform a partnership contract."

Likewise we find the same rule announced in the matter of *McMurtrey & Smith* (D. C., Tex.), 142 Fed. 853, 15 Am. B. R. 427. The first headnote in that section is as follows:

> "A bankrupt is insolvent and subject to adjudication as a bankrupt when the partnership property is insufficient to pay its debts, regardless of the individual property of the partners."

The Court will note that decisions cited by the Supreme Court, from which we quote above, support our position in this matter.

Respectfully submitted,

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Attorney for Appellant.